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PROBLEM LOANS MANAGEMENT SYSTEM IN BANK

Advisability of a systematic approach to problem loans management in bank is justified. It was determined that problem loans management system in bank should be defined as its structural and functional integrity of an object, a subject, principles and a mechanism. The interaction of these elements allows minimizing losses which may arise from the relationships with borrowers. The article described the strategy of bank's problem debts' mitigation.

Keywords: problem loans management, problem loans, the subjects of management, strategy of problem debts regulation.

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СИСТЕМА УПРАВЛІННЯ ПРОБЛЕМНИМИ КРЕДИТАМИ В БАНКУ

Визначено доцільність використання системного підходу до управління проблемними кредитами в банку. Склад системи управління проблемними кредитами в банку визначено як сукупність елементів, взаємодія яких дозволяє мінімізувати втрати у взаємовідносинах з позичальниками. Надано характеристику стратегіям врегулювання проблемної заборгованості в банку.

Ключові слова: проблемний кредит, управління проблемними кредитами, суб'єкти управління, стратегія врегулювання проблемної заборгованості.

Табл. 1. Рис. 4. Літ. 14.

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СИСТЕМА УПРАВЛЕНИЯ ПРОБЛЕМНЫМИ КРЕДИТАМИ В БАНКЕ

Обоснована целесообразность использования системного подхода к управлению проблемными банковскими кредитами. Систему управления проблемными кредитами предложено определять как совокупность элементов, взаимодействие которых позволяет минимизировать потери банка во взаимоотношениях с заемщиками. Охарактеризованы стратегии регулирования проблемной задолженности в банке.

Ключевые слова: проблемный кредит, управление проблемными кредитами, субъекты управления, стратегия регулирования проблемной задолженности.

Introduction. While forming and developing credit policy for 2014 - 2015 banking institutions in Ukraine should first of all take into account the fact that it will be implemented under the influence of an unfavourable environment that is very unpredictable due to global recession. Uncertainty in financial and commodity markets will generate significant variability of the economic situation in Ukraine. Unfavourable macroeconomic situation may lead to deterioration in the financial conditions of borrowers and thus possible increase in bad debts. As such, there is an objective need for problem loans management in bank to be improved.

Analysis of the research and publications. The issue of bad debts mitigating in banking system is actively investigated in the context of financing, control and credit risk management. Such authors as V. Danilishyn (2012), L. Kloba (2009), V. Kloba (2010), V. Mishchenko (2009), L. Sloboda (2011) made a special contribution to the development of the issue. Significant scientific results that allowed forming methodological and organizational framework for problem loans management in banks was achieved by Russian academics: A. Alexandrov (2010), O. Kovanev (2009), S. Kuznetsov (2008), O. Nurzat (2011), M. Smykov (2012) M. Yashin (2010).

Remaining part of the problem. Despite the fact that domestic and foreign scientists made significant progress developing the topic, it should be noted that many issues related to the theoretical principles and practical aspects of problem loans management in banks (object definitions and business management principles formation, the factors that should be considered in system formation management, methodology) are not highlighted enough.

The main aim of the study is to generalize existing theoretical approaches and practical experience to forming a system of problem loan management in banks (hereinafter –PLMSB) that can effectively function under economic instability. These results will be used as a basis for further development and improvement of the system.

The main results of the study. We suppose that problem loans management system in banks should be based on systematic approach, the application of which will improve the decision making process and optimize the organizational structure. The most important characteristics of any system are its structure (elements of structure and relationships between them) and functions (the ability of the entity to conduct operations to achieve defined goals).

That is why we believe that the problem loans management system is a structural and functional integrity of related elements (objects, subjects, principles and mechanisms). The interaction of these elements allows minimizing losses which may arise from the relationships with borrowers.

Credit exposures position which we offer to identify as the risk of potential bank losses which arises from the inability of the borrower to meet obligations under the influence and by the interaction of external and internal factors, is the object of managerial influence.

The definition mentioned above allow us formulating the purpose of problem loans management system, which is to minimize potential losses in the bank's relationship with the borrower-risk carrier. In the most general terms, it is determined by the amount of funds provided to the borrower, and the probability of default (probability of default of the borrower).

We suppose to view subjects of problem loans management system as a set of general management bodies that are responsible for general credit policy in the bank (the Supervisory Board, the Board of Directors) and special control bodies that are directly involved in dealing with problem loans (the Credit Committee, the Departments that directly manage problem loans and the Support Centres managing problem loans).

In forming PLMSB one should not only be guided by the above-discussed principles but should also take into account factors that affect the control (Figure 1).

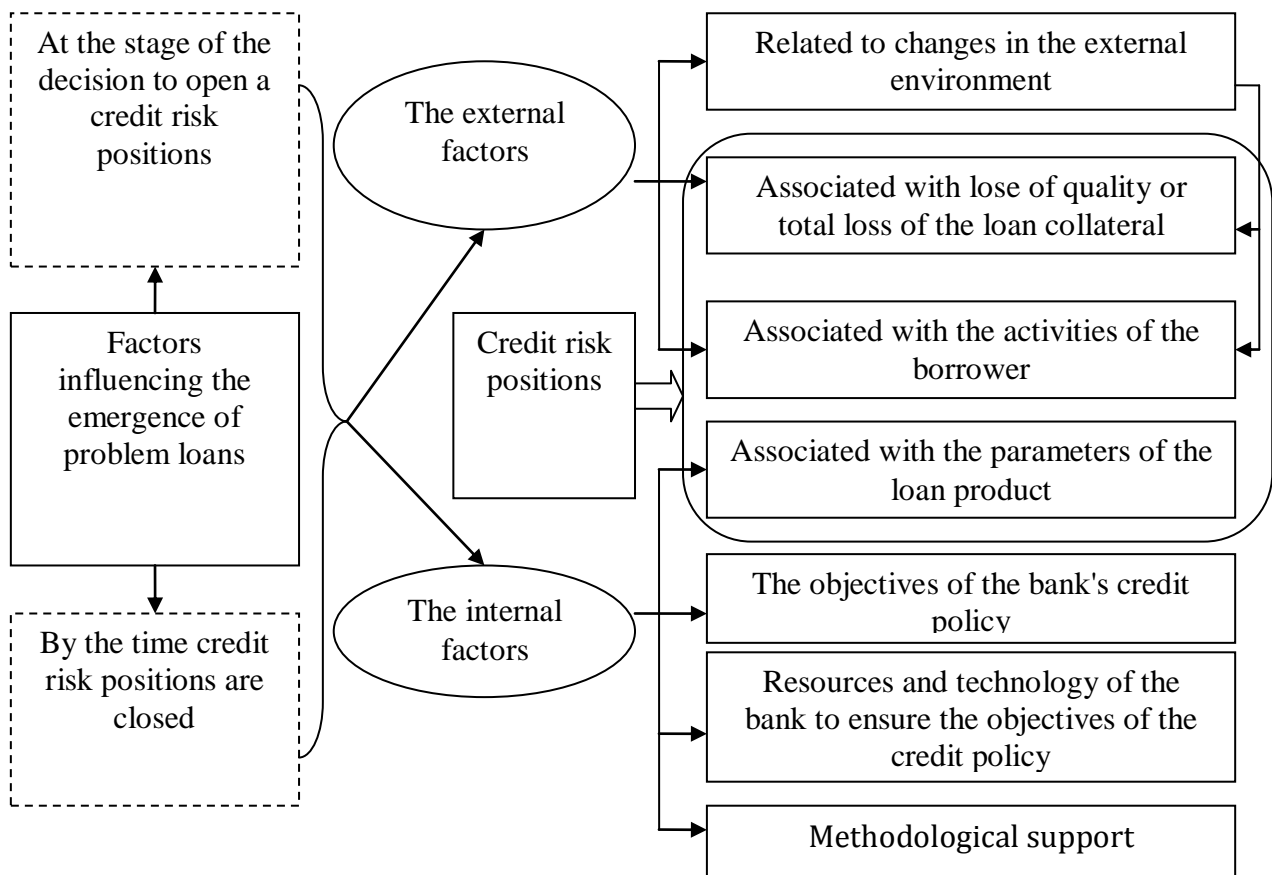


Figure 1. **Factors to consider when managing problem loans.** Authoring The external (uncontrollable) factors include:

a) Factors related to the environment, which has a double effect: the borrower and its ability to fulfil his obligations (economic, social and political conditions in the country) and the possibility to regulate bank credit risk positions (the level of economic interest protection of creditors provided by law, the effectiveness of regulation and supervision). Their composition is relatively large and heterogeneous, but impact is very significant and hardly predictable;

b) Factors that are related to the partial or complete loss of collateral (for material collateral – lose of value, a significant impairment in the period of the loan agreement, damage or total loss of the collateral, for financial collateral - counterparty's inability to fulfil its obligations, loss of reputation);

c) Factors that are related to financial, reputational characteristics of the borrower arising from his inability of the borrower to fulfil their obligations under the influence and by the interaction of external and internal factors.

Abilities and instruments external factors' control are very limited, but bank can mitigate their impact and avoid significant losses. Primary focus should be given to factors related to the borrower and the collateral as only they ultimately determine the credit risk profile of the bank and its' credit risk positions. Effective credit policy is the main instrument for the prevention of the negative impact of this group of factors.

Loan product parameters are internal factors that are primarily related to the characteristics of credit risk position. They affect the rate of losses from defaults and distribution of credit exposures.

An in-depth study require internal factors that are not directly related to the characteristics of credit risk positions, but ones that determine the credit risk profile of the bank and the possibility of bad debts appearing. We suggest consolidating these factors into three groups. The first defines the objectives of credit policy that are aligned to objectives of the bank. In case of an incorrect set of the policy the level of strategic risk increases. In our opinion, that was one of the causes of the banking crisis in Ukraine. The second group of internal factors in the bank determines the available resources (financial, material, labour, information) and technologies for achieving these goals, including the ability of management to use them effectively.

To prevent the occurrence of problem loans it is important to determine whether a bank has enough resources to achieve the objectives set out in its credit policy or not. Some of the elements of resources are defined by an ability of rapid transformation over time and may be subject to credit policy purposes (e.g., introduction of innovative technologies, the appropriate training of credit managers).

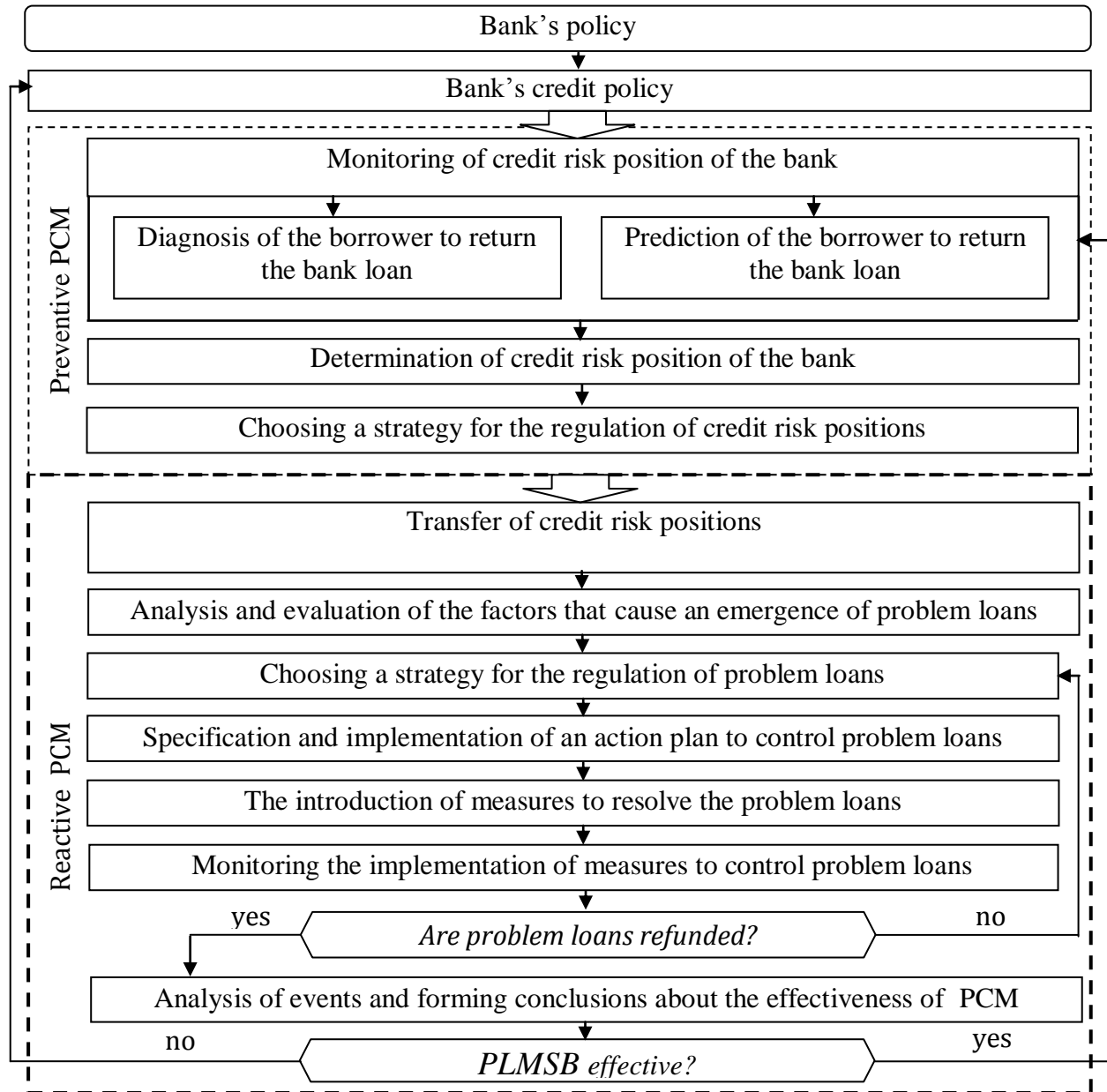
The other elements of the resources have limited opportunity for transformations over time due to market constraints, lack of financial resources and other reasons (e.g., to increase its share capital, a significant increase in logistics). Therefore, objectives of credit policy and its implementation mechanism should take into account resource constraints while building internal capacity of the bank, which will prevent the emergence of problem loans. The third group includes methodological support (regulations, procedures, process cards, etc.) of credit process, credit risk management, and problem loans management approved by the relevant bodies of the bank. That should be based on the principles of corporate governance and is consistent with its practical implementation.

An integral part of any system, including PLMSB are functions such as planning (formation of credit policy), regulation (management influence to deviations of the actual characteristics of credit risk positions from planned and measures for its mitigation), analysis (study of credit risk positions and evaluate their sensitivity to changes in factors of external and internal environments and governance impact) and control (supervision and verification of conformity of the actual and planned characteristics of credit risk positions). Efficient interaction of these functions is implemented through the mechanism of problem credit managements on both preventive and reactive levels (Figure 2).

As noted above, preventing the proliferation of bad loans in the bank requires the introduction of evidence-based credit policy, the purpose of which is to control credit risk in the process of ensuring the most efficient allocation of credit resources to obtain the maximum possible income from lending operations.

Credit policy should identify the following approaches used in lending and, in case of effective implementation will prevent the emergence of bad loans: 1) the creation and implementation of qualitative and quantitative credit risk assessment; 2) standardization of loan products including establishing clear procedures and methods of analysis of potential borrowers with a view to reduce a prime cost of credit services and improve customer service; 3) fixing of flexible credit terms depending on the type of credit product (program, individual, complex); 4) complex credit risk

management that is carried by structural subdivisions within their credentials on all stages, whether application is pending or under support: 5) ensuring controlling of a proper funds usage by the borrower.



PCM – problem credits managing

Figure 2. **Problem loans management mechanism of bank.** Developed by authors

On the basis of developed credit policy and its' requirements, a preventive problem loans management system is implemented on a permanent basis and includes:

- monitoring of risk positions for signs that may indicate the occurrence of problem loans;
- diagnosing of the borrowers' ability to repay his debt and determination on the basis of diagnosis the characteristics of exposure (standard credit loan, pre-bad loan stage; loan with clear signs of problems).

If loan is detected to be with severe symptoms of problematic nature, it activates reactive management, which involves the introduction of measures to control bad debts.

While working with problem loans the bank can use two controlling strategies: recovery strategy and liquidation strategy (Figure 3).

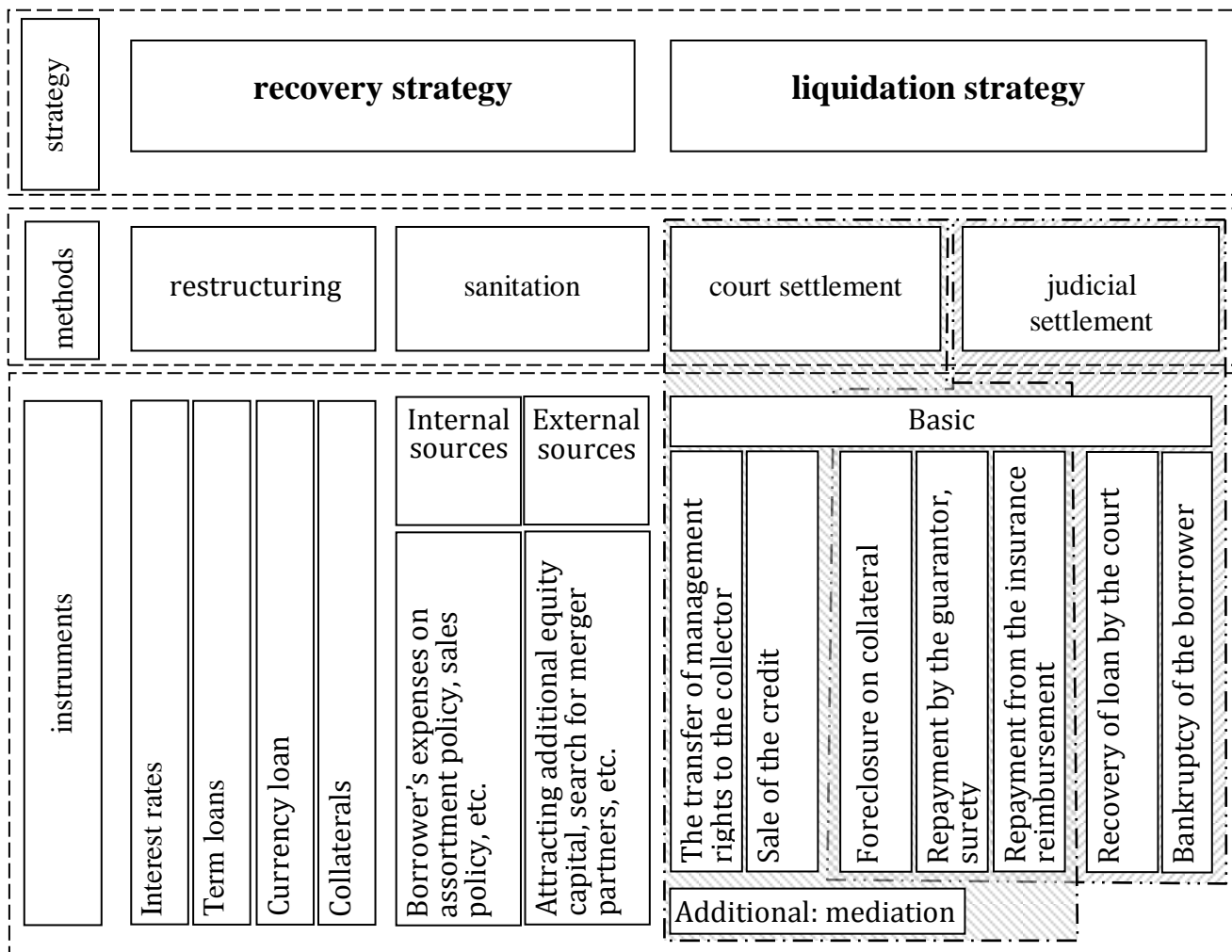


Figure 3. Support of the reactive problem loans management in bank.

Developed by authors

Restructuring (changing the initial conditions of the contract) is the main method of problem loans recovering when the debtor is unable to meet his obligations. Restructuring agreement may consist of the following elements: collateral restructuring, restructuring of a payment schedule (extension of credit term, grace periods), restructuring charges for loan (changing loan schemes from the classic to the annuity, reduced interest rate), conversion of loan and interest, write-off fines and penalties etc. The decision on restructuring must be substantiated and adopted in the same manner as the decision to grant credit. This method is effective when the problems of the borrower are temporary and are not systematic. It should be mentioned that that in domestic banking practice this method is often used wrongly to disguise bad loans and improve bank's financial ratios disclosed in reports.

Recovery of bad loans may provide for rehabilitation, ie the development of activities that are carried out jointly by the bank and the borrower to prevent his bankruptcy. Measures conducted as part of the sanitation can be divided into those that mobilize internal reserves of the borrower (reduction in receivables, cut-off of unprofitable business units, reducing of the amount of fixed and variable costs, selling non-core assets, etc.), and such that involves finding external sources of funding (additional capital raising, seeking new partners, etc.). Remediation is very expensive method, which does not give instant results, so the bank must carefully assess their capabilities and appropriateness of use.

If the loan recovery strategy recognized inappropriate or does not lead to expected results, a bank applies the methods of enforcement of principal and interest (to carry out the liquidation of credit) for full reimbursement of bad debts.

Methods for liquidation of credit include: enforcing the collateral, liquidation of bad debts by the guarantor (surety), insurance reimbursement from insurance agencies within the time limits specified by the rules of insurance, transfer of toxic assets to a third party (collector) without bank's balance optimizing, transfer / sale troubled assets to independent financial company (SPV onshore / offshore); sale of toxic assets to independent financial company under factoring, legal action (set of measures for their enforcement).

Reasonability of implementation of these methods in a particular bank's practise is defined by such criteria's as: guarantee of the result, costs to implement the chosen method, duration of action, impact on reputation, potential external and internal risks, and a degree of dependence on results from external and internal factors.

Moreover, the choice of method bank has to take into account the peculiarities of accounting and taxation, the impact on the regulatory capital adequacy, liquidity providing, increase management efficiency, reduce risk and ensure profitability of the loan portfolio.

If it is impossible to return bad loans, a bank can use formed reserves in the manner prescribed by the National Bank of Ukraine.

Conclusions. The article defines the structure of the problem loans management system in bank as the structural and functional integrity of the objects, subjects, principles and mechanism of the interaction which minimizes losses while dealing with borrowers.

We state that it is crucial to develop and select proper methods and strategies to manage problem loans depending on the characteristics of the bank and the borrower, so there are objective prerequisites for further research in this area.

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